HOUSE BUDGET COMMITTEE

Democratic Caucus

The Honorable John M. Spratt Jr. # Ranking Democratic Member

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June 7, 2001

Tax Cut and Budget Gimmicks

Dear Democratic Colleague:

I commend to you the attached *USA Today* editorial examining the budgetary gimmicks in the tax bill that the President signs today. Some Members of Congress thought that they had reached a compromise with Republicans on the size of the tax cut, limiting its eleven-year cost to $1.35 trillion. But by stipulating that all the bill's tax breaks would expire at the end of 2010 and using other sleight-of-hand, Republicans pushed through a far larger tax cut while pretending to abide by the $1.35 trillion agreement.

As the editorial points out, it is not just the gimmicks in the bill itself that conceal the true cost of the Bush tax agenda. Another major part of the problem is the tax package's omission of any mention of inevitable changes to the tax code over the next several years—like fixing the alternative minimum tax (AMT) and extending expiring tax provisions. Addressing these looming problems will have a significant additional impact on the surplus.

The Center on Budget and Policy Priorities estimates that the revenue loss from the tax bill without its sunsets plus the cost of fixing the AMT and tax extenders comes to $1.9 trillion. Adding the higher interest payments to bondholders that result from using the surplus for tax reduction rather than debt reduction brings the total impact on the surplus to $2.3 trillion. This would dissipate more than 80 percent of the surplus available outside of Social Security and Medicare, leaving very little for anything else. There is no conceivable way that the remaining resources would suffice to meet our other pressing needs—like improving education, modernizing the military, providing an adequate Medicare prescription drug benefit, and strengthening Social Security and Medicare before the baby boom generation retires.

Basing the budget of the United States for the next decade and beyond on flawed planning like that in the tax bill is a costly mistake.

Sincerely,

John M. Spratt, Jr.
Ranking Democratic Member

USA Today 6-6-01

Today's debate: Cutting taxes

Tax-cut gimmicks portend return to deficit spending

Our view:

Fine print of soon-to-be-signed legislation hides true cost.

When President Bush signs the tax cut into law Thursday, he will get everything he wanted, and more. Basic tax rates will be trimmed to almost exactly the levels he proposed. The so-called marriage penalty will be phased out. The child tax credit will double. Congress even tossed in lots of new tax breaks that Bush hadn't sought. It amounts to a tremendous political victory for a president elected by the narrowest of margins, delivered by a divided Congress at breakneck speed. But it also is a time bomb that could explode in the public's face and perhaps Bush's as well.

Gimmicks embedded in the plan virtually guarantee that the cost will balloon during the next decade far beyond its $1.35 trillion price tag, turning what could have been a reasonable tax cut into a gamble that could easily lead the U.S. back into deficit spending.

At its advertised price, the tax cut is reasonable. According to the latest budget figures, surpluses will be large enough in the next decade to return that much money to taxpayers and add nearly $1 trillion in new spending, without touching the $2.5 trillion in Social Security and Medicare surpluses.

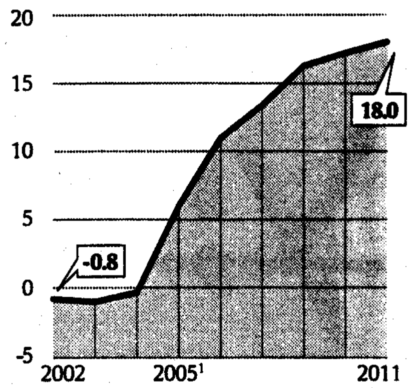
By taking so much money off the table, the tax law also imposes some semblance of needed fiscal discipline on Congress. Once budget surpluses emerged in 1998, lawmakers went on a spending spree, boosting spending by nearly 8% a year. The new budget pulls that back to a still-generous 4% a year to make room for the tax refunds.

But the bill contains several clever provisions designed to hide its true costs. Among them:

▶ **Long phase-ins:** Some provisions won't fully kick in for 10 years. Even the tax-rate reductions won't be complete until 2006. The marriage-penalty relief doesn't even start until 2005. The per-child tax credit doesn't reach $1,000 until 2010. These all make the tax bill look small in the near term, but cause the size of the tax cut to explode in later years.

Tax rolls increase

One way Congress artificially kept the cost of the tax bill down was by canceling reform of the Alternative Minimum Tax (AMT) in 2005 and exposing millions of families to the costly AMT. Here is the number of taxpayers exposed to the AMT under the new tax law, compared with current law (in millions):

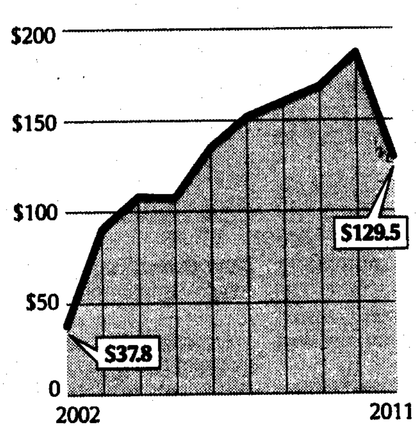


1 – reform expires
Source: Joint Committee on Taxation

By Quin Tian, USA TODAY

Congress juggles numbers

The tax bill squeezes into a $1.35 trillion hole only by slowly phasing in provisions and then canceling all of the tax cuts at the end of 2010. Here are the annual costs ($ billions):



Source: Joint Committee on Taxation

By Quin Tian, USA TODAY

▶ **Sunset provisions:** One key provision in the bill – a fix to the so-called Alternative Minimum Tax (AMT) – simply dies out in a few years. That means millions of middle-class taxpayers will be exposed to new tax bills after 2004 through the AMT, once designed as a way to keep the rich from avoiding taxes altogether. And the entire tax bill expires after 2010. Left unchanged, these provisions shave billions from the advertised price of the 10-year tax plan.

This is artful political math, even if it's fiscally foolish. Bush and congressional Republicans are gambling that future Congresses won't have the stomach to let the cuts expire. Earlier this week, for instance, Treasury Secretary Paul O'Neill claimed that "all these things are going to become permanent. They'll all be fixed." That, in turn, creates pressure to reduce the size of government and denies Democrats fuel for their agenda.

But that calculus comes at a high risk for a nation soon to face the costs of the aging baby-boomer generation. "Fixing" these provisions, as O'Neill suggests, would push the tax cut's cost to nearly $2 trillion over 10 years, possibly more. That should choke off Republican spending priorities – for defense modernization, for instance – along with those of Democrats, which begin with prescription-drug coverage for the elderly. More likely, both sides will try to spend the money anyway, using phony fiscal projections and leaving their successors – and retiring baby boomers – with a return to deficits at the worst possible moment.

And that assumes a return to the level of economic growth that produced today's surplus. If productivity growth doesn't live up to expectations, the market doesn't perform as well as it has lately and business profits slump, then the rapid flow of money into the treasury will dry up. Already, in fact, the sluggish economic growth has stanched revenue flows, forcing Congress to shift corporate tax payments to different years as a way to make the budget numbers add up in the near term.

No doubt Bush will be smiling when he signs the tax cut. But he won't be around to clean up the mess this tax bill is set to unleash on the country.